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MEMORANDUM FOR:

The Honorable Walt W. Rostow  
Special Assistant to the President  
The White House

Attached is your personal copy of  
our memorandum, Economic Pressure for  
Change in Eastern Europe, IM 68-33,  
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Director of Economic Research  
Central Intelligence Agency

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DIRECTORATE OF  
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# Intelligence Memorandum

*Economic Pressure for Change in Eastern Europe*

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MARCH 1968

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CENTRAL INTELLIGENCE AGENCY  
Directorate of Intelligence  
March 1968

INTELLIGENCE MEMORANDUM

Economic Pressure for Change in Eastern Europe

Summary

Economic pressure is a major force for political change in Eastern Europe. For 20 years and more the Communist regimes have driven their economies, keeping them under close political control and almost entirely insulated from the world market. Until about 1960 the leaders still hoped to "overtake and surpass" Western Europe, thus "demonstrating the superiority of socialism." By now everyone, including the leaders, realizes that Eastern Europe is not even in the same league with Western Europe. The Eastern European countries produce at higher cost a much inferior range of goods and services, and in these respects they are not gaining on Western Europe but falling behind.

The threat to the Eastern European regimes is twofold. First, the young are intolerant and impatient of waste and shortages -- as of oppression and humbug -- and they have leaders among the new elite, in and out of the Party. Second, the Eastern European states cannot capture the national feeling of their people or secure independence in foreign affairs without becoming competitive in world markets. With second-class economies, they are becoming more dependent on the USSR, in spite of the yearning of the elite for more independence. The leaders are on the defensive in the face of these challenges.

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and coordinated with the Office of Current Intelligence.

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Economic problems pose an immediate threat only in Czechoslovakia, where the Party in January dropped long-time boss Antonin Novotny, chiefly for not dealing with them effectively. As the people see it, especially the young and the elite, it is the fault of the Party that the economy, while growing, has deteriorated so much. When the Communists took over in 1948, Czechoslovakia was better off than West Germany. Now, output per capita is only about two-thirds and consumption about three-fifths of the West German level -- aside from major differences in quality and mix of output. In no other country have the Communists thrown away such opportunities.

In the other countries, mounting discontent with living conditions and the fear of increased dependence on the USSR have less political impact. The economic problems of East Germany are almost as serious as those of Czechoslovakia. But the division of Germany and the dominant Soviet role in East Germany, handicaps imposed by history, have relieved the East German Communists of much of the responsibility for East German economic problems. Rising economic pressures on Hungary and Poland probably do not pose an immediate danger; for memories of 1956, though fading, are still a restraining influence on political action. In the less developed countries, Bulgaria and Rumania, discontent with living conditions is just emerging as a political problem, and the leaders still have time to try to make their economies competitive, although the outlook is not encouraging.

In response to mounting criticism, all the Eastern European regimes have adopted "economic reforms" in the 1960's, beginning with the East German announcement in mid-1963. Criticism has focused on mistakes in economic policy and the inefficiencies resulting from bureaucratic control. The reforms are intended to correct these weaknesses by giving the planning staffs the training and tools needed to support economic policy and by gradually turning over economic decisions to industrial management and replacing the sanctions of plan fulfillment with those of the market -- supply and demand, profit and loss.

- 2 -

~~CONFIDENTIAL~~

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The leaders and the Party hierarchy have accepted economic reform with major reservations. They see a need for developing stronger, more professional planning and management, but they distrust economists and other experts as politically undependable and -- strange as it may seem -- impractical or visionary. The reforms are therefore carefully hedged about to assure political control and to prevent economic disruption. The planners have been given more of a voice in policy but still do not carry a great deal of weight. They have not persuaded the leaders to adopt a "low pressure" economic policy, to concentrate on "qualitative changes" (in efficiency and product mix) even at the expense of increased output. The leaders still seem to believe in reform and rapid growth, a policy that overdetermines the choices open to planners and management and leaves them to follow the line of least resistance, which has generally been to increase output as the leaders want. The industrial managers have acquired more authority, but mainly in matters that the central bureaucracies never succeeded in controlling -- the precise composition of output, wage payments, and investment in additional plant and equipment.

Yet differences in approach are important, not so much differences in the reform programs as in substantive economic policy. Economic policies differ on such vital questions as how hard to push the economy, how much to reduce the overstuffed economic apparatus, what to do about incompetent Party hacks in planning and management, how much inflation to accept, how fast to close down grossly inefficient enterprises, and whether to risk substantial unemployment. Policy on such questions will largely determine the effect of the present reforms.

Czechoslovakia and Hungary present a contrast in economic policy, even though their reform programs are much alike -- both look to eventual reliance on "market forces" to police economic decisions. Czechoslovakia has been less than "half-hearted" (reformer Ota Sik's word) in support of the first cautious steps toward reform. Insistence on rapid increases in output, plus the dead weight

- 3 -

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~

of the old bureaucracy, has made the reforms inoperative and is likely to lead to renewed economic difficulties, although the recent changes in the leadership may help to avoid critical difficulties. Hungary, on the other hand, has carefully controlled the pressure for increased output and has prepared the way for reform by upgrading management and cutting back the central economic bureaucracy by 30 to 40 percent. Thus Hungary, moving with all deliberate speed, may accomplish something through economic reform. The other countries have followed the East German model, which emphasizes the development, not of "market forces" but of highly professional planning and management. Reform in these countries has a dual purpose: on the one hand, to raise efficiency and adapt output to the market, and on the other, to increase effective central control. The East Germans have carried out this program with characteristic energy and considerable success, although their obsession with rapid growth is likely to land them in trouble. The German drive is lacking in Bulgaria, Poland, and Rumania. Bulgaria, which has not yet put its reform program into full operation, and Poland and Rumania, which are still experimenting, probably will not have much to show for their efforts at economic reform -- nor are they likely to run into serious economic trouble in the near future.

Under present policies, the chronic economic problems of Eastern Europe will persist. In some countries they may become acute in the next two or three years -- probably in Czechoslovakia, unless the new leadership imposes more realistic policies, and possibly in East Germany. The leaders have even less room for maneuver in economic than in political matters, and reform will add to Eastern European frustrations and internal political tensions. As economic pressures increase, some of the Eastern European countries may seek closer political relations with the West, especially with Western Europe, as a way out of their economic difficulties. Only with political backing and large-scale economic support from the West can any Eastern European country carry out basic changes in policies and institutions.

- 4 -

~~CONFIDENTIAL~~

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The Symptoms of Economic Inferiority

1. The symptoms of deep economic problems in Eastern Europe are of two kinds: inefficient use of resources and unsuitable characteristics of the output of goods and services. Inefficiency has great political impact; people can see (and feel) it as workers and consumers. Deficiencies in the quality and mix of goods and services are also obvious to everyone, and equally offensive. These deficiencies are a basic weakness of the Eastern European economies -- a major cause of continued inefficiency in using resources (the wrong goods are fed back into the system) as well as a major reason for popular dissatisfaction and the weak position of Eastern European goods on foreign markets. The Eastern Europeans themselves have come to admit -- indeed emphasize -- the seriousness of these problems. They realize that the problems are built into plant and equipment, the habits of management and workers, and the very institutions of the command economy.

2. The inefficiency of the Eastern European economies relative to Western Europe appears clearly in the low productivity of investment. During the postwar period the productivity of investment (annual increment of output per unit of investment) has been lower in the Eastern European countries than in Western European countries that were also subject to the ravages of World War II.\* In the late 1950's the productivity of investment in Eastern Europe rose to the Western European level, largely because of the one-time increase in efficiency flowing from the great rise in Soviet material deliveries to Eastern Europe, which did away with the acute shortages of the earlier years. But in the 1960's the productivity of investment has dropped to only two-thirds of the Western European level. If data for the two countries most affected by cyclical movements, Czechoslovakia and West Germany, are eliminated from the comparison (or adjusted to dampen the cyclical swings), this relationship has been quite stable since the early 1960's. That is to say, if Eastern Europe is not

\* See "Postwar Economic Growth in Eastern Europe (A Comparison with Western Europe)," by Maurice Ernst, *New Directions in the Soviet Economy*, Joint Economic Committee of Congress, Washington, 1966.

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falling further behind, neither is it gaining. And, although there is a considerable range in the productivity of investment in both Eastern and Western Europe, there is little overlap between the ranges for the two areas. If Czechoslovakia and West Germany are left out of the comparison (or the fluctuations in their data adjusted), investment costs in every Eastern European country are consistently higher than the average for Western Europe.

3. Inventory costs have also run higher in Eastern Europe, more than double the Western European level. In Western Europe, annual increases in inventories average about 1½ percent of GNP (the annual averages range from 1 to 2 percent).<sup>\*</sup> In Eastern Europe, after allowing for differences in national accounting, the average is about 3½ percent of GNP (varying from year to year between 3 and 4 percent). Moreover, the share of inventories in GNP has been rising in Eastern Europe but not in Western Europe. As with the productivity of investment, there is little overlap between the ranges for the two areas.

4. Largely because of higher investment and inventory costs, economic growth has been much more expensive to Eastern than to Western Europe. Eastern Europe has achieved about the same rates of growth as Western Europe by allocating a smaller share of GNP to consumption. In Western Europe over 75 percent of GNP (at market prices) goes to consumption; in Eastern Europe, only about 60 percent of GNP (valued at the same prices).

5. Eastern Europe is also less efficient in the use of current inputs. Czech economist Ota Sik, a leader in economic reform, recently indicated that Czechoslovakia uses two to three times as much steel and fuels as most Western countries use to produce a given amount of industrial output. He made the following comparison (tons of input per \$1,000 of industrial output):

<sup>\*</sup> From data for the European countries in OECD (the Organization for Economic Cooperation and Development), which includes all the Western European countries except Finland, Switzerland, and Spain as well as the United States and Canada.

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	<u>Steel</u>	<u>Fuels</u>
Czechoslovakia	0.44	5.05
France	0.19	1.60
West Germany	0.32	
Italy	0.23	
Sweden		1.90
United States	0.19	2.60

Such differences may be increasing. The conversion of the Eastern European economies from coal to oil, the retiring of obsolete equipment (which has finally begun in earnest), and improvements made in the range of rolled steel products available are examples of developments that could bring Eastern European unit costs down toward the Western European level. But at the same time, Western Europe has moved far ahead in other respects, as in the use of light metals and of synthetic and plastic materials.

6. Finally, the Eastern European countries have been inefficient in the use of labor. A comparison of countries with about the same output per worker before World War II would show that, relative to the prewar level, labor productivity has grown less rapidly in Eastern than in Western Europe.\* The lag is greatest for the more advanced countries. Labor productivity in Eastern Europe now averages somewhere between 15 and 20 percent lower relative to the Western European level than it was before World War II. (It was then 5 to 10 percent below the Western European level.) The difference increased in the early 1960's and was reduced somewhat in 1966-67.

7. The explanation of these persistent differences in efficiency is closely bound up with another aspect of inefficiency in Eastern Europe -- the unsatisfactory product mix. Part of the output of goods (and services) is of substandard quality. Output of a good many products is greater than can be sold; other products could be sold in greater amounts than are produced. The range of choice (sizes, qualities, styles) is far narrower than in Western Europe. Finally, the mix does not include many of the newer products available in Western Europe -- a disadvantage almost equally annoying to women looking for this

\* The growth of labor productivity since 1950, however, is about the same in the two areas because recovery was slower before 1950 in Eastern Europe.

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~

year's styles in clothes and manufacturers seeking equipment that has long since been available to their Western competitors.

8. The inferior mix of goods produced in Eastern Europe has contributed heavily to the inefficiency of the Eastern European economies -- to high investment and inventory costs and the wasteful use of materials and labor. As inferior materials and equipment (whether of domestic origin or from other Communist countries) are fed back into the economy, it becomes harder to improve efficiency -- and to produce the right goods.

9. Nevertheless, the process could perhaps continue indefinitely were it not that the inferior mix of goods and services also meets increasing consumer resistance both at home and abroad. Inventories have accumulated mainly for this reason. Producers are left holding unusable goods that they have bought and unsaleable goods that they have produced. At the same time they hoard scarce high-grade commodities. Trade organizations likewise acquire large stocks of goods for which there is little or no demand.

10. The scarcity of desirable consumer goods and services is shown, for example, by a leveling off of sales of shoes and clothing in the more developed countries, large earnings by private handicraft workers, long waiting lists for buying automobiles and some other consumer durables, excess demand for meat and butter as a surrogate for other goods, and continued rationing of housing.

11. A rapid rise in savings deposits suggests the general reluctance to buy the goods available. Since 1955, while personal incomes have increased by anywhere from one-half to one and one-half times, savings deposits have increased between ninefold and more than 25-fold. The rise in savings also reflects the scarcity of goods in another way. Large savings deposits are needed for buying housing and automobiles (and in some countries other consumer durables). These goods are so scarce, trading organizations can require a full cash deposit from anyone that wants to get on a waiting list.

12. The political consequences of failing to satisfy consumer demand are evident. The older generation in Eastern Europe is willing to put up

- 8 -

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with scarcity -- it has known worse -- but the rising generation is not prepared to, as the leaders are uneasily aware.

13. Paralleling this concern is anxiety over export trade. The highly industrialized countries, Czechoslovakia and East Germany, have already run into heavy going in all their export markets. Their customers in the Communist world, on whom they have depended heavily for basic materials, no longer value East German and Czech machinery as they once did. The less developed countries of Eastern Europe are less and less willing to exchange agricultural and industrial materials for Czech and East German machinery. The price of increasing trade with them is to reduce net exports of machinery to them, by delivering less machinery or accepting more, or both. The USSR is obliged to continue its deliveries of materials in order to support the Communist regimes in these two countries. But the USSR is nevertheless insistent that Czechoslovakia and East Germany take more Soviet machinery in order to get Soviet materials and is becoming increasingly choosy about what goods it will accept in return, especially in the case of machinery. The Soviet government is also insisting on price changes in its favor; it is no longer willing to pay Western European prices for inferior Eastern European manufactures.

14. The poor quality and mix of Czech and East German manufactures is an even more serious handicap in trade with Western Europe and generally with the Free World. The market for highly processed Czech and East German manufactures is not large. Most of them can be sold only at prices well below those brought by similar Western European goods. Czech estimates indicate that the average unit prices of exports to the West declined by more than one-third from 1948 to 1953 and by at least one-fifth from 1953 to the present -- while prices on Western markets were rising. At present, exports from both Czechoslovakia and East Germany to the European Common Market bring on the average only about one-half the price paid for similar Western goods from outside the Common Market.

15. By accepting these unfavorable prices, Czechoslovakia and East Germany have been able in the 1960's to raise the share of highly processed

- 9 -

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~

manufactures in their exports to developed Western countries. Yet it is still relatively low. Their chief export, machinery and equipment, representing more than one-half their total exports to Communist countries, amounts to less than one-fifth of their exports to developed Western countries. Moreover, there are signs that highly processed exports are likely to increase more slowly from now on, partly as a result of more intense competition on Western markets. Deliveries in 1967 rose very little.

16. The other Eastern European countries have better prospects in the short run than Czechoslovakia and East Germany, but they face the same problems in the longer run. As yet the Soviet government does not have such strong economic reasons to bring pressure to bear on them -- although there may be pressure for political reasons, as Rumania has complained -- because the weight of highly processed manufactures is lower in their exports to the USSR and higher in their imports than in the case of Czechoslovakia and East Germany. They do not face great resistance to the expansion of their machinery deliveries, for they buy large amounts of Soviet machinery. But they too must reckon with the more competitive market that is developing in the Communist world.

17. In trading with the West, Hungary and Poland still have some advantage and Bulgaria and Rumania a great advantage in that their exportable surpluses of basic materials are still growing, if less rapidly. Most agricultural and industrial materials find a market, and these countries are more concerned with general market conditions, which have hurt sales and prices -- for example, for Polish coal -- and with restrictions on trade than with their ability to compete. All four of these countries are looking ahead, however, to the time when problems of both supply and demand will cut into their basic materials exports. They are already trying to get a foothold for their highly processed manufactures, including machinery, in Western markets.

18. For all the Eastern European countries the stakes are high. To compete in the increasingly integrated market in Western Europe is a necessity for any Eastern European regime that proposes to maintain or increase its bargaining power with Moscow -- and its political independence.

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Criticism and Reforms

19. In trying to deal with inefficiency and the poor quality and mix of output, the Eastern European regimes are drawing on a body of critical opinion that has developed out of endless debates over plans and policies and from analysis by economists. Debates on plans and policy take place behind closed doors, coming into the open only when the disagreements are deep and become widely known within the *apparat*, as has happened in Czechoslovakia, East Germany, and Poland. Commentary and analysis by economists have been published since the mid-1950's, mainly in Czechoslovakia, Hungary, and Poland. These two lines of criticism played an important part in the abortive economic reforms of Poland in 1956-57 and Czechoslovakia in 1958-60 and have again become influential in the 1960's.

20. The reforms of the 1960's began with Walter Ulbricht's announcement of the East German "New Economic System of Planning and Management" in June 1963. The "New Economic System" was designed for Ulbricht by Erich Apel, with very little public discussion. The next reform program, the "New Economic Model" of Czechoslovakia, was adopted most reluctantly by Party boss Antonin Novotny in January 1965, after wide public debate lasting more than a year. In both cases, however, the criticism of high officials and economists acquired great force because the leaders had made bad errors of judgment, over the objections of their economic advisers. The difference in approach between Ulbricht and Novotny reflects the difference between a shrewd opportunistic politician and an inflexible and weary one.

21. In the other countries, as well, criticism has been a major factor in getting the regimes to adopt reforms. To be sure, the decision of the Polish leadership to adopt a program of its own in mid-1965 was influenced by the favorable attitude of the new Soviet leadership. (The full-scale Soviet program, based on Khrushchev's experiments, was approved in September 1965.) Without doubt the Soviet example likewise helped to persuade Bulgaria to adopt a general economic reform of its own in 1966. But in these countries, and even more decisively in Hungary and Rumania, which followed suit in 1966 and 1967, respectively, the leaders were mainly reacting to the mounting volume of sharp criticism from key officials and experts supported by arguments from the other Eastern European countries.

- 11 -

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~

22. The first general feature of the reforms -- which has received relatively little attention -- is the effort to convert the economic planning staffs from bureaucracies mainly concerned with allocations and priorities into economic advisory staffs capable of giving continuous guidance on policy. The leaders and the Party hierarchy, although jealous of their prerogatives in setting policy, have acknowledged the need for a much higher level of professional competence and for developing modern information systems to serve policy -- as well as operating -- needs. A substantial investment is being made in training economists in Western analytical techniques, in standardizing statistical systems, and in building up a computer network. Besides emphasizing better day-to-day control over the economy, the programs call for better forecasting techniques and for experiments with systems analysis and operations research.

23. The second main feature of the reforms is the attempt to develop responsible industrial management, which can make its own decisions on what to produce and how to produce it. Management responsibilities are concentrated in superenterprises called "associations," "trusts," "industrial centers," and the like. These are large enough to permit some economies of scale. Their average employment runs from more than 20,000 people in Bulgaria, East Germany, and Poland to 30,000 in Czechoslovakia.\* At the same time the superenterprises are few enough to be overseen from the capital (Poland, with 150 superenterprises in industry alone, has the largest number). They are nevertheless small and numerous enough not to have much chance of influencing policy. Only Hungary has omitted this feature in its economic reforms. The Hungarian reform is based on a rather extensive consolidation of enterprises, but only a couple of superenterprises have been established.

24. The superenterprises are intended to operate in a "businesslike" fashion somewhat like subsidiaries of large Western corporations, with ample authority over day-to-day decisions, direction of applied research, access to foreign customers, opportunity to invest on a substantial scale on their own

\* Rumania's industrial centers have not yet been set up.

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account (from retained profits and bank credits), and some control over prices (mainly of high-grade clothing and other "luxuries"). The obligatory quotas are to be relatively few and general, for the most part not interfering with the judgment of management on exactly what to produce. In Hungary, management can lay off workers, subject to review by the labor union. In return for added responsibility, management is being offered substantial incentives for getting results. Hungary, which has gone the furthest, offers a bonus to the manager of up to 80 percent of the basic salary when profits are large but threatens to take away up to 25 percent of the basic salary if the enterprise shows a loss.

25. In agreeing to these reforms, the leaders have left in the hands of the central bureaucracies practically all of their effective control over the economy, giving up only authority over matters that they have never really controlled -- chiefly the detailed mix of output, the scheduling of production, and the like. Among other things, the central bureaucracies still appoint managers, impose legally binding quotas for aggregate output and exports and for the production of key products, establish prices (or price limits) for all essential products, ration scarce commodities, allocate foreign exchange, control the volume of bank credit, and restrict management in hiring and firing.

26. Moreover, the leaders have generally been reluctant to recognize that the effectiveness of economic reform depends heavily on their willingness to follow through with major reforms in the economic bureaucracy and the role of the Party and with basic changes in economic policy. In short, they accept even modest reforms with grave reservations, which appear when vested interests and established policy are involved.

#### Reform in Action

27. Public speeches and political reporting give some idea of the political attitudes affecting economic reform -- the characteristic activist approach of the East Germans, the halfheartedness (to use Ota Sik's word) of the leadership in Czechoslovakia, the cautious eclecticism of the Hungarian regime, and the playing down of reform in the other countries. Such evidence suggests that only the

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Hungarian and East German reforms may be expected to accomplish much -- in their quite different ways. This impression is partly borne out by comparing what the regimes have done to disturb the *status quo* to reduce the economic bureaucracy, replace unqualified executives, close down enterprises, and tolerate a rise in unemployment.

28. Hungary is the only country that has substantially cut down the economic bureaucracy. In preparation for the economic reforms of 1968, Hungary reduced employment in the economic ministries by 30 to 40 percent and abolished the subordinate staffs between the ministries and enterprises. The other countries (except Poland) have been reducing employment in central administration, but only slightly, and the reductions have been more than offset by staffing the superenterprises and by strengthening local administration. Poland has increased central administration besides beefing up the superenterprises. Thus reform would seem to involve little reduction in "petty tutelage" except in Hungary. To reduce the central bureaucracy is one of the main problems facing the new leadership in Czechoslovakia.

29. The East Germans stand out for the promotion of young, trained executives to take major responsibilities. When in 1964 the "industrial associations" (originally set up in 1958) were given a major role to play as superenterprises, new managers were appointed in well over one-half of the 89 associations; in heavy industry, about two-thirds of the number. As a result of these changes, the average age of the managers dropped to about 45 years. About one-third had university degrees and nearly one-half had some advanced training, mostly in engineering and economics. On the average, they had more than 10 years' experience in their special fields. Finally, and perhaps most interesting in the closed society of East Germany, there were only two prewar Communists in the group and only eight identified as having joined the Party before 1950. On the other hand, the group included at least 12 former Nazis, of whom two had been members before 1940.

30. Nothing like this wholesale appointment of "new" men has taken place elsewhere in Eastern Europe. The Hungarian regime has been gradually replacing managers, often even with non-Party men.

~~CONFIDENTIAL~~

The others have not claimed significant results. One of the main complaints of the reformers in Czechoslovakia is the incredibly low level of competence in management. After the Communists took over, loyal Party men were given most of the management jobs, pretty much without reference to qualifications. Even now, nearly one-half have not completed secondary school and one-third have only a primary school education. The educational qualifications of managers are even lower than in Poland -- another problem facing the new leadership.

31. Readiness to close down inefficient enterprises is most evident in Czechoslovakia and predates economic reform. In a program drafted in 1963-64, Czechoslovakia proposed to close down high-cost mines and many small manufacturing enterprises. A substantial part of this program has already been carried out. Coal and iron mines employing some 30,000 people stopped production in 1964-65, and blast furnaces associated with some of the iron mines also closed down. About 1,300 small manufacturing enterprises, chiefly in light industry and engineering, went out of business in 1964-65, throwing 33,000 workers out of their jobs. Most of the displaced workers found jobs quickly in the same line of work or in expanding industries; some went into agriculture. In East Germany the policy has been rather to merge inefficient enterprises with stronger ones or to convert them to new lines of production, and there has probably been little unemployment. In neither Czechoslovakia nor East Germany is the regime likely to close down large enterprises, however unprofitable they may be, although Czechoslovakia has reduced employment in some of the big coal mines. The Hungarian regime is cautious in its public statements, indicating only that unprofitable enterprises will eventually have to go out of business. Hungary likewise is not likely to put large enterprises out of business, although the government -- or the banks -- may force changes in management and in output. Rumania is planning to close down some of the least efficient oilfields when jobs are found for the employees. Bulgaria and Poland have no immediate intention of closing down enterprises, so far as is known.

32. Both Hungary and Poland seem to envisage the possibility of substantial unemployment, as indicated by plans to send workers to East Germany, where the

- 15 -

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~

shortage of labor is most acute. Increasing numbers of Polish workers have been observed in East German industrial enterprises, and Hungary and East Germany reportedly have agreed on the shift of 100,000 Hungarian workers, beginning with 20,000 in 1968. It is indicative of a new attitude that the regimes are willing to forego the services of considerable numbers of workers, especially in the case of Hungary, which does not have large labor reserves. Both countries are actually proposing to cut back the rate of economic growth (from the 1956-65 average), and in both cases it is clear that the decisive reason is not the lack of labor but rather the desire to shift from "extensive" to "intensive" growth.

33. The final, acid test of reform is whether the leaders are prepared to reduce the pressure for expanding output, as their economic advisers recommend. As yet no leader has been willing to go far in that direction. All are intent on increasing output from year to year about as fast as they think they can. As the leaders see it, this question is quite distinct from economic reform. From the point of view of Eastern European economists, on the other hand, and of many planners and managers, the two questions are closely related. For them, economic reform -- in its "first stage" -- is a legal and administrative framework for carrying out a "low pressure" economic policy, in which to make "qualitative" changes (in efficiency and product mix) even at the expense of increased output. Some policy level officials have been won over to this argument, but it has not been generally accepted as policy.

34. The leaders clearly want reform *and* growth, thus overdetermining the choices open to planners and management and leaving them to follow the line of least resistance, which has generally been to increase output as desired. Within this general pattern, however, there are differences from country to country that may prove important politically and economically. These are considered in the following section.

Policies on Economic Growth

35. The continued pressure by the leadership for economic growth is well indicated by the 5-year plans for total output (net material product) for

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1966-70. Differences in pressure are also indicated. When the revised plans for annual rates of growth in this period are compared with average rates of growth in 1956-65 (as shown in the table), it appears that one country, Czechoslovakia, is planning on a higher annual rate in 1966-70; that two, Hungary and Poland, are expecting lower rates than in 1956-65; and that Bulgaria, East Germany, and Rumania are projecting about the same rate that they achieved in the previous period. The new Party leadership in Czechoslovakia may cut back existing plans -- it is still too early to say.

Eastern Europe: Average Annual Rates of Growth  
of National Income a/  
1956-65 and Planned 1966-70

	Percent		
	Actual 1956-65 (Official Statistics)	Planned 1966-70	
		Original	Revised
Bulgaria	8.2	8 to 8.4	8.4
Czechoslovakia	4.5	3.5 to 3.9	5.5 to 5.7
East Germany	5.4	4.4	5.1 to 5.7
Hungary	5.2	4	4
Poland	6.4	5.4	5.7
Rumania	8.0	7.0	8.0

*a. National income, Communist concept, excludes value added in "nonproductive" services (the services of government and many professional and personal services).*

36. The comparison is indicative because all the countries have reason to expect a declining rate of industrial growth. All suffered through the mid-1950's from a shortage of materials and thereafter obtained a one-time gain from the enormous increase in Soviet deliveries that followed. All now face increasing difficulty in meeting the demands of

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customers. To be sure, there are offsetting developments -- in particular, recent improvements in the performance of agriculture; the acquisition in the 1960's of substantial amounts of Western plant and equipment; and technical improvements in planning that should dampen the costly cyclical movements of 1956-65.

37. None of these factors applies equally to all Eastern European countries. On balance, the negative factors count most heavily against the advanced countries; the positive factors, most heavily in favor of the backward countries. Thus Czechoslovakia and East Germany have the least reason to expect continued growth at the 1956-65 rate; Bulgaria and Rumania, the most reason. Accordingly, it would appear that while all the countries are indeed pressing to increase output about as fast as possible, Czechoslovakia and perhaps East Germany are projecting increases that cannot be obtained at any price.

38. These judgments seem to correspond with those of the planners themselves, as suggested by a comparison of the earliest versions of the plans proposed in 1964-65 with the "final" versions adopted in 1966 or early 1967. Czechoslovakia has raised its goal for the annual growth of national income several times, from the first goal of 3.5 to 3.9 percent (somewhat below the actual level of 1956-65) to the last one, adopted in late 1967, of 5.5 to 5.7 percent (higher than in 1956-65). The East German targets have also been raised significantly. Bulgaria, Hungary, and Poland, on the other hand, have made no significant change. Rumania has raised its sights, but chiefly on the basis of improved expectations in agriculture that are more or less justified on the basis of recent experience. The comparisons are shown in the table.

39. A considerable body of evidence on the development of these plans corroborates these indications of differences in policy from country to country. Conflicts over plans have occurred in all countries, as was to be expected. But these have been prolonged and intense only in Czechoslovakia. The disputes in East Germany were also bitter but apparently were resolved -- after the suicide of chief planner Erich Apel in December 1965 -- by splitting the difference between the planners and

- 18 -

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~

the politicians. In all the other countries the evidence suggests that the final plans represent estimates that the planners believed feasible, even if not advisable.

Economic Pressure and Political Change

40. In conclusion, the Eastern European regimes have even less room for maneuver in economic than in political matters. Their stability depends on getting along with the USSR, on not repudiating the record of the last 20 years, and on not sacrificing the vested interests of the Party and the state bureaucracy. The economic reform movements, therefore, are likely to add to rather than reduce Eastern European frustrations and thus create additional problems for the leaders. Major changes in economic policies and institutions probably must await basic political changes, in which shifts in the international environment are likely to be the decisive factor. Major changes almost certainly involve much closer political relations with Western Europe, for the sake of political security and economic support. Large-scale economic support is essential to help the Eastern European countries to reintegrate into the world market. With their small, inefficient economies, they could benefit greatly, but the costs of making their economies competitive would be enormous and would have to be underwritten by Western governments and businesses.

41. Many Eastern Europeans would like to find a way of tapping Western skills and technology on a much greater scale than at present. About one-half of the \$4.5 billion worth of machinery and equipment imported from the West in the 1960's has been bought on credit. Net drawings on Western credit through 1967 amounted to nearly \$1.5 billion, a significant addition to domestic resources, especially for Bulgaria and Rumania, which have borrowed the most. But the outstanding credits, which run from one to two years up to eight years -- occasionally even longer -- must be repaid, the greater part by 1970. Future drawings will barely exceed repayments, for most of the leaders are unwilling to go much further into debt. Thus borrowing from the West will not provide an important source of new financing from now on.

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42. A great deal of effort has gone into promoting cooperative arrangements of various kinds ("joint ventures") with Western businessmen for marketing Eastern European products in the West. These deals, which sometimes involve technical assistance, provide useful training for Eastern Europeans. But they affect a negligible share of Eastern European exports to the West, and are not likely to furnish a significant amount of capital to Eastern Europe.

43. Probably the only way in which Eastern Europe can get access to Western capital on a large scale is through the growth of much closer political relations, accompanied by the adoption of business-like economic policies. Yugoslavia, which has gone much further in these respects than any of the Eastern European countries is likely to go in the near future, has obtained substantial backing from the Export-Import Bank and some from the World Bank, but even Yugoslavia has not solved the problem of accommodating Western risk capital. The Eastern European countries have a long way to go before they have a chance of solving the problem, but it is one of the conditions of their becoming competitive, independent countries with stable governments.

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